Statement of
MARY CUNNINGHAM
PRESIDENT/CEO
USA FEDERAL CREDIT UNION

On behalf of the
CREDIT UNION NATIONAL ASSOCIATION

Before the
FINANCIAL INSTITUTIONS SUBCOMMITTEE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
JULY 11, 2007

Chairwoman Maloney, Ranking Member Gillmor, and members of the Financial Institutions Subcommittee, thank you for inviting me to appear before the Subcommittee today to express the views of the Credit Union National Association (CUNA) on the issue of check overdraft protection and the legislation you introduced early this year, the "Consumer Overdraft Protection Fair Practices Act" (H.R. 946). CUNA is the nation's largest credit union advocacy organization, representing over 90% of our nation's approximately 8,800 state and federal credit unions, their State credit union leagues, and their 89 million members.

My name is Mary Cunningham and I am President and CEO of USA Federal Credit Union based in San Diego, California. I also serve as Chairman of the National Credit Union Foundation, the philanthropic and social responsibility arm of the nation's credit union system. My credit union career spans thirty-three years. USA Federal Credit Union was founded in 1953 in order to serve the needs of civilian employees working for the Naval Training Center in San Diego, California. Over the past fifty plus years we broadened our field of membership to serve all branches of the military as well as select employers in and around San Diego and Riverside Counties. We operate a network of 23 branches, including 7 branches in South Korea and 4 branches in Japan, all located on military installations. Over half of our 60,000 members are military families. As a not-for-profit member-owned financial cooperative, we provide a wide variety of financial services to meet the needs of our unique market, including low-cost payday loan alternatives, affordable mortgage products, small business services, our overdraft privilege pay product, as well as a series of programs designed to provide personal financial counseling and education.

Madam Chair, credit unions have long been involved in providing some form of overdraft or bounced check protection for their members. This is fully consistent with the philosophy and mission of the credit union industry to serve members' financial needs and to help them resolve short-term financial problems. Initially, many credit unions simply provided members with courtesy transfers from their savings accounts to cover any checks that exceeded the balance in their savings accounts. However, as members' savings declined and the complexity of electronic banking increased both the number and dollar amounts of overdrafts, it became imperative to find new and innovative approaches to better address this member need.

Today, many credit unions continue to offer their members overdraft protection by providing a set number of automatic transfers from regular savings or money market accounts. Others also provide special lines of credit attached to checking accounts to protect against overdrafts or to allow for special purchases. Still others have followed the example of the banks in structuring formal courtesy pay or overdraft privilege programs. While the terms and features of these overdraft privilege programs may vary, most are consistent in offering to pay, rather than return, non-sufficient funds transactions on checking accounts in exchange for fees that are similar to those typically charged for returned items. All these programs are intended to spare members the embarrassment of returned checks as well as avoid additional fees charged by merchants.

As more credit unions began to initiate overdraft protection programs, CUNA sought to encourage its members to adopt "best practices" standards to distinguish credit union overdraft services from many bank programs that were being marketed to boost fee income without regard for the best interests of consumers. It adopted policy positions in 2004 supporting the ability of credit unions to offer overdraft privilege programs, but urging credit unions to avoid practices that are inconsistent with the philosophy and principles that are unique to the credit union system *(see "Attachment" for CUNA's full policy statement*). In particular, CUNA called on credit unions to refrain from:

- Deceptive advertising that leads consumers to expect all overdrafts to be paid when other documents indicate payment of overdrafts is discretionary;

- Promoting overdraft protection in a manner that encourages consumers to frequently or regularly overdraw their account;

- Enticing consumers to overdraw their accounts by including the amount of overdraft coverage as part of "available funds" in ATM messages, online statements and telephone balance statements; and

- Failing to inform frequent users of overdraft protection services of available alternatives that could be more appropriate and less expensive.

Given the commitment of credit unions to respond to the particular needs of their field of membership, few credit union overdraft privilege programs operate in exactly the same manner. And many programs have changed over time in response to members' needs and usage. The Privilege Pay program offered by USA Federal Credit Union clearly illustrates this point. Shortly after implementing an overdraft protection program in the Fall of 2003, my board and I asked staff to evaluate who was using the program, how often, and whether the program was encouraging more overdrafts than before the program was introduced. Our research revealed the following:

- 26% of those using privilege pay were less than 25 years old. For a military credit union serving young enlisted and their families, we considered this to be disturbing news.

- The average NSF transaction that triggered Privilege Pay was under $100.

- 44% of our users of this product accessed it between 2-5 times each month.

- 37% of these users were chronic overdrafters prior to implementation of the product. Once implemented, an additional 28% became chronic overdrafters.

- We also learned that roughly 75% of all overdrafts resulting in Privilege Pay were triggered by ACH and point of sale activity rather than check clearings.

Credit Unions have a rich history of providing a fair deal to consumers – low loan rates, high savings rates, and modest fees. But instead of Privilege Pay being used as we had intended, a number of our members chose to use it as a no-qualifying line of credit. And for a member who lives paycheck to paycheck, these fees add up quickly. Once a member maxed out his privilege pay limit of $750, the next paycheck was automatically spent once deposited, thereby creating a downward spiral for the member. When that happens, we're no longer offering a fair deal. We're adding to his problems.

To be fair, I must also tell you that we've received testimonials from members who were very grateful that the math errors in their checkbook didn't result in the embarrassment and expense of a returned check. They truly love the product and were thrilled that we cleared rather than returned the item.

So our challenge was this: how can we offer a sensible product that members can rely upon to save them the embarrassment of having a check returned while at the same time ensuring that controls are put in place to help our members to help themselves? Here are the modifications we made to the product. Many of these modifications mirror the main points in your proposed legislation:

1. Our Privilege Pay product is offered to members at the time the checking account is opened, along with the transfer from savings option and the Overdraft Line of Credit option. The member is informed that they will automatically qualify for Privilege Pay after 30 days of good activity and aggregate deposits of at least $750, unless they choose not to have the service.

2. We follow a practice of liberally refunding fees while educating the members about the service. We also encourage members to "opt out" if they decide they don't want the service.

3. Part of that education consists of explaining to members how the clearing process works at USA Federal: All items, regardless of presentment method, are cleared in ascending order by dollar amount, with the smallest dollar amount being

cleared first. We always post credits to the account first, then debits. This helps to minimize fees for the member.

4. We also inform the member that our system first attempts to transfer from shares, then to a Line of Credit Overdraft Protection Loan, and finally, to Privilege Pay as a last resort. While these programs are offered at the time the checking account is established, none are overtly marketed to the members.

5. When a member attempts to make a withdrawal at an ATM, the actual balance is disclosed to the member – not the available balance through Privilege Pay. We did inquire to our ATM processor to see of a warning notice could be provided at the point of sale about the transaction triggering Privilege Pay, but were told this feature was unavailable. While I agree with your bill's recommendation that such a notice should be provided, I would also tell you that very few credit unions drive their own ATM networks and would be unable to ensure compliance on their own. I would encourage sufficient time for phasing in this portion of the bill so that third party providers could make the necessary software adjustments to support this full disclosure.

6. We also imposed a maximum ceiling on the number of Privilege Pay fees that could be assessed on a given day, regardless of the number of items presented. That maximum is five.

7. And finally, all notices to the members regarding Privilege Pay fee assessments include a toll free number to Balance, which is a financial counseling service that we provide at no charge to all members.

In summary, Madam Chair, we view Privilege Pay as one of those programs that, like many things in life, can be a wonderful tool for the consumer if used in the appropriate way for the appropriate reasons. But also like many things, when taken to excess, it can do certain damage to the consumer and add to their financial burdens rather than assisting them.

Your bill attempts to protect consumers from paying fees for a service they did not ask for or know they would receive. Credit unions would agree.

Your bill attempts to ensure that such fees are disclosed to the member during the enrollment period as well as at the point of sale. Credit unions would agree, but would encourage this portion to be phased in so that third party providers may have time to comply.

Your bill attempts to ensure that fees for Privilege Pay be conspicuously disclosed in a separate periodic statement with a calculation of the APR. Credit unions would agree and we clearly support disclosure of all costs related to these programs. We also believe that consumers would benefit from being able to make direct cost comparisons between various overdraft options offered by a credit union and those offered by other institutions. However, depending on how the fee is defined and included within APR calculations, it could easily exceed the credit unions' statutory 18% interest rate ceiling on consumer loans not secured by real estate, and it would force most credit unions to stop providing this service at a lower cost than comparable bank programs.

We would offer the following alternative solutions for your consideration:

1) Add an amendment to the Federal Credit Union Act to the bill providing a specific exemption for overdraft protection fees from the 18% APR limit. This would still permit APR disclosures and consumer cost comparisons, but would not prevent credit unions from offering the service;

2) Amend the Truth in Lending Act to define overdraft protection fees as a service fee, rather than a "finance charge," and require only disclosure of the dollar amount of the fee; or

3) Require that only that portion of the overdraft protection fee that exceeds the normal NSF fee it is intended to avoid or replace should be considered a finance charge (this is consistent with Federal Reserve guidelines).

Finally, your bill attempts to prohibit financial institutions from employing methods of manipulating the process of posting an item against an account in order to generate overdrafts and the associated fee income. Credit unions would agree.

I would like to thank the Subcommittee for the opportunity you have provided to me to express the views of the Credit Union National Association as well as those of my own credit union.

Attachment

Credit Union National Association (CUNA)

POLICY ON OVERDRAFT ("BOUNCE") PROTECTION PROGRAMS

(Adopted 2004)

Position: CUNA strongly supports the ability of credit unions to offer bounce privilege plans as a means to help their members resolve short-term financial problems. This is in contrast to others who may heavily market these programs in order to boost fee income, without regard to the best interests of the consumer. CUNA calls on every CUNA member credit union to adopt bounce privilege standards and ethical guidelines that will help emphasize credit unions' concern for consumers and further distinguish credit unions as institutions that care more about people than money.

CUNA will work with key policymakers and regulators to ensure that they understand the benefits that credit union bounce privilege plans provide for the members, consistent with the credit unions' role as not-for-profit, consumer-owned financial institutions. Bounce privilege services, when offered, as a valuable alternative to bouncing share drafts, are fully consistent with the philosophy and principles unique to the credit union system.

When offering such services, credit unions adopting these guidelines and ethical standards recognize that the following practices are not consistent with the credit union philosophy and principles and publicly affirm that they will not engage in any of these practices:

- Deceptive Advertisement: Advertising, representing, or implying that the member should expect that all overdrafts will be paid but then stating in other documents that the paying of overdrafts is discretionary, which is a standard feature of bounce privilege plans. Such advertising may lead members to rely on the service in expectation that all overdrafts will be paid, which would be detrimental if any overdrafts are not ultimately paid by the financial institution.

- Enticing Members to Overdraw Accounts Repeatedly: Advertising or promoting the bounce privilege plan in a manner that encourages the member to overdraw repeatedly his or her share draft account, as opposed to such a plan being used as an occasional convenience for the member. The frequent overdraw of accounts is a practice that financial education programs, such as those offered by credit unions, generally discourage.

- Structuring Programs that Mislead Members: Including a feature that records the amount of coverage being offered to cover bounced share drafts as part of the "available funds," such as on ATM receipts, online statements and telephone balance statements.

- Failure to Inform Heavy Users of Bounce Privilege Programs of Alternatives: Bounce privilege programs may not be appropriate for members who heavily use and rely on bounce privilege programs as a means to pay a significant proportion of every day living expenses. For these members, credit unions may offer a number of other products and services that would be more appropriate. These may include transfers from a savings account to the share draft account, as well as other types of less expensive secured and unsecured loans that the credit union offers to all its members.